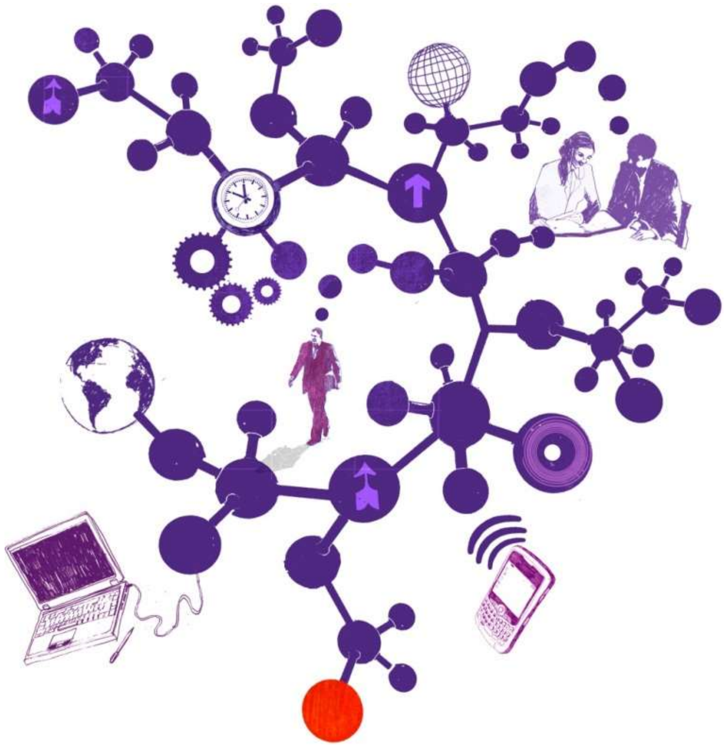
Informing the audit risk assessment for the Police and Crime Commissioner for West Mercia and Chief Constable for West Mercia

Year ended

31 March 2017



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Purpose

The purpose of this report is to contribute towards the effective two-way communication between the external auditor and the Joint Audit Committee, as part of the Committee's role in advising the PCC and the Chief Constable (who are "Those Charged with Governance (TCWG)") according to good governance principles and to adopting appropriate risk management arrangements in accordance with proper practices, The report covers some important areas of the auditor risk assessment where we are required to make inquiries of TCWG under auditing standards.

Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with TCWG. ISA(UK&I) emphasise the importance of two-way communication between the auditor and TCWG and also specify matters that should be communicated.

This two-way communication assists both the auditor and TCWG in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from TCWG and supports TCWG in fulfilling their responsibilities in relation to the financial reporting process.

Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and TCWG's oversight of the following areas:

- Fraud
- Laws and regulations
- Going concern.
- Related Parties
- Accounting estimates

This report includes a series of questions on each of these areas and the responses we have received from management. The Joint Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

Fraud

Issue

Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both TCWG and management.

Management, with the oversight of TCWG, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight in supporting TCWG, the Joint Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with TCWG regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how TCWG, supported by the Joint Audit Committee oversees the above processes. We are also required to make inquiries of both management and TCWG as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from management. We have also received responses from TCWG which are presented as a separate paper at this meeting.

Fraud risk assessment

Question	Management response
Has the organisation assessed the risk of material misstatement in the financial statements due to fraud or error? What are the results of this process?	The risk has been assessed as low. The structure of the Finance Directorate has ensured that there are sufficient, professional resources in the team to minimise the risk of error in the financial statements which was reflected in the positive comments made by Grant Thornton in their Audit Findings Report for 2015/16. Fraud was not identified as part of the risk management process as a significant risk; it doesn't feature in the risk register.
How are the Joint Audit Committee satisfied that the overall control environment is robust? In particular what processes does the organisation have in place to identify and respond to risks of fraud in the organisation?	The head of internal audit forms an opinion as to the overall control environment on an annual basis There is an overall documented anti-fraud corruption strategy available on the internet. Processes in place include: • Controls within all systems • Financial regulations • Contract standing orders
Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?	Fraud was not identified as part of the risk management process as a significant risk; it doesn't feature in the risk register.
Are internal controls, including segregation of duties, in place and operating effectively? If not, where are the risk areas and what mitigating actions have been taken?	Internal audit systematically review the existence and operation of internal controls and weaknesses are addressed. For example the bank reconciliation process has been assigned to different posts that are not involved in system administration or preparing payment runs in the entity concerned. The Joint Audit Committee ensure the Audit Plan provides adequate coverage and focuses on areas of greatest risk.

Fraud risk assessment (continued)

Question	Management response
Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?	The Chief Constable is accountable to the PCC for performance against the delegated budget. The PCC is ultimately responsible to the public for delivering efficient and effective policing in the area. Each is supported by a S151 finance officer governed by the Financial Management Code of Practice and a professional code of conduct. In turn the S151 officers have a body of staff reporting to them who administer financial systems and prepare financial reports and accounts. The checks and balances inherent in this arrangement means that one individual cannot exert undue pressure and the likelihood of systematic misreporting across the Office of the PCC and staff of the Chief Constable is very unlikely.
How does the Joint Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What arrangements are in place to report fraud issues and risks to the Joint Audit Committee?	The risk register is reviewed by the Joint Audit Committee. Internal and external audit progress updates and reports are presented at each Joint Audit Committee meeting. An implementation progress report is presented at each Joint Audit Committee meeting detailing progress against the implementation of recommendations This would depend on the nature and scale of the fraud, and could be via the internal auditors regular/annual reports, or by a separate report for larger scale frauds.
How does the organisation communicate and encourage appropriate business practice and ethical behaviour of its employees and contractors?	The College of Policing Code of Ethics has been adopted by the force as part of the vision and values. Work has been undertaken to embed this in the organisation. The use of Strategic Business Managers, professional standards regular newsletters and Ethical Dilemma emails promotes good business practice.
How do you encourage employees to report their concerns about fraud? Have any significant issues been reported?	A harmonised approach across the alliance for employees to confidentially report concerns is available on the Intranet. Employees can either call the Integrity line or complete an online reporting form, both methods are anonymous. The whistle-blower policy follows the recent guidance issued under Annex H of the Home Office Guidance on Police Officer Misconduct Procedure No significant issues.

Fraud risk assessment (continued)

Question	Management response
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	No; related party relationships and transactions are subject to disclosure. Related party transaction forms are completed and reviewed to detect any instances of fraud or issues that require disclosure.
Are you aware of any instances of actual, suspected or alleged, fraud, either within the organisation as a whole or within specific departments since 1 April 2016? If so how does the Joint Audit Committee respond to these?	No
Are you aware of any whistle-blower reports or reports under the Bribery Act since 1 April 2016? If so how does the Joint Audit Committee respond to these?	No

Laws and regulations

Issue
Matters in relation to laws and regulations ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements. Management, with the oversight of TCWG, is responsible for ensuring that the organisation's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements. As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and TCWG as to whether the entities are compliant with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements. Risk assessment questions have been set out below together with responses from management. We have also received responses from TCWG which are presented as a separate paper at this meeting.

Impact of Laws and regulations

Question	Management response
What arrangements do the Organisations have in place to prevent and detect non-compliance with laws and regulations?	It is the role of the monitoring officer to ensure compliance with laws and regulations. The PCC's Chief Executive is the monitoring officer. The Chief Finance Officer (Section 151 Officer) also fulfils this role.
How does management gain assurance that all relevant laws and regulations have been complied with?	Reliance is placed on internal audit and management judgement.
How is the Joint Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	The Joint Audit Committee receives internal and external audit reports. Annually both the Chief Constable and Police and Crime Commissioner present an Annual Governance Statement for review by the Joint Audit Committee
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2016 with an on-going impact on the 2016/17 financial statements?	No.
What arrangements do the Organisations have in place to identify, evaluate and account for litigation or claims?	Specific claims are received by the Force and investigated in conjunction with the Force Insurers, Legal Services and Professional Standards. A reserve is placed on the claim and reviewed annually as part of the process of producing the financial statements to determine whether a provision or contingent liability needs to be disclosed. Environmental scanning identifies general issues that might impact on the Force and these are evaluated in light of the evidence.
Are there any actual or potential litigation or claims that would affect the 2016/17 financial statements?	No, there are no specific and material claims that would have a significant impact on the 2016/17 financial statements which are known to us at the time of preparing this statement.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No.

Going Concern

Issue
Matters in relation to going concern ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements. The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. The code of practice on local authority accounting requires Police Bodies' financial statements to be prepared on a going concern basis. Although the Organisations are not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern assumption provides an indication of the Organisations' financial position and is good practice. A key consideration of going concern is that the Organisations have cash resources and reserves to meet its obligations as they fall due in the foreseeable future. Going concern considerations have been set out below and management has provided its response. We have also received responses from TCWG which are presented as a separate paper at this meeting.

Going Concern Considerations

Question	Management response
Do the Organisations have procedures in place to assess the Organisations' ability to continue as a going concern?	Regular medium term financial plans are reported to the Police and Crime Commissioner and the Police and Crime Panel, which demonstrate continuing financial viability
Is management aware of the existence of events or conditions that may cast doubt on the Organisations' ability to continue as a going concern?	Medium term financial plans do not indicate that there are any conditions that may cast doubt into the Organisations' ability to continue as a going concern
Are arrangements in place to report the going concern assessment to the Joint Audit Committee? How has the Joint Audit Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?	Various financial reports such as treasury management reports are presented to the Joint Audit Committee. Internal and external audit reports are also presented which would highlight any going concern risks. No significant issues have been reported to the Joint Audit Committee as a result of the above mechanisms that would suggest that it isn't appropriate to prepare the accounts on a going concern basis.
Are the financial assumptions in financial reports (e.g. future levels of income and expenditure) consistent with the Organisations' Business Plan and the financial information provided to the Police and Crime Panel throughout the year?	Yes, medium term financial plans and budgets and financial monitoring reports are consistent with the Organisations' Business Plan and the financial information provided to the Police and Crime Panel.

Going Concern Considerations (continued)

Question	Management response
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Statutory and policy changes are considered when reviewing the medium term financial plan .
Have there been any significant issues raised with the Joint Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No significant issues have been reported to the Joint Audit Committee that would cast doubt on the appropriateness of assumptions made in in the production of financial reports, forecasts and budgets.
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	The financial reports provided to the Joint Audit Committee are comprehensive enough to provide assurance about key financial indicators including those under the prudential framework. The levels of reserves are assessed by the Treasurer to the PCC as being appropriate. Cashflow is forecast and monitored.
Do the Organisations have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Organisations' objectives? If not, what action is being taken to obtain those skills?	Resources are constantly reviewed and steps taken to ensure any shortfalls in staff numbers, skills and experience are addressed, either through short-term recruitment or permanent appointments. A review of the alliance structure (finance) has been completed to ensure the posts, roles and responsibilities are fit for purpose.

Related Parties

Issue
Matters in relation to Related Parties Police Bodies are required to comply with International Accounting Standard 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include: ■ entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Organisations (i.e. subsidiaries); ■ associates and/or joint ventures; ■ an entity that has an interest in the Organisations that gives it significant influence over the Organisations; ■ key management personnel, and close members of the family of key management personnel, and ■ post-employment benefit plans (pension fund) for the benefit of employees of the Organisations, or of any entity that is a related party of the Organisations. A disclosure is required if a transaction (or series of transactions) is material on either side i.e. if a transaction is immaterial from the Organisations' perspective but material from a related party viewpoint then the Organisations must disclose it. ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate. Related party considerations have been set out below and management has provided its response.

Related Parties (Continued)

Question	Management response
What controls do the Organisations have in place to identify, account for, and disclose related party transactions and relationships?	Related party transactions disclosure forms are completed on an annual basis by all Senior Officers. Business interests of police officers and staff are updated on an annual basis. A Register of Interests is also maintained for both the PCC and Deputy PCC which is available on the internet. Annual accounts disclosures for related party relationships and transactions are required under The Code of Practice on Local Authority Accounting
Who have the Organisation identified as related parties?	Worcestershire County Council Unitary, District and Borough Councils in the West Mercia Area Other Police Forces Home Office Other government departments including the Office for Communities and Local Government Place Partnerships Ltd. Inside Products Ltd.

Accounting Estimates

Issue
Matters in relation to accounting estimates Police Bodies need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate. Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Organisations identify the transactions, events and conditions that may give rise to the need for an accounting estimate. Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all material estimates that the Organisations are using as part of their accounts preparation; these are detailed in Appendix A to this report. The audit procedures we conduct on the accounting estimate will demonstrate that: • the estimate is reasonable; and • estimates have been calculated consistently with other accounting estimates within the financial statements. Accounting estimates considerations have been set out below and management has provided its response.

Question	Management response
Are the management aware of transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgment?	Yes; significant estimates that management are aware of are detailed in appendix A
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
How is the Joint Audit Committee provided with assurance that the arrangements for accounting estimates are adequate?	The S151 officers review the basis of the estimates as part of their review of the accounts prior to them being signed off. External audit report to the Joint Audit Committee the findings of their audit of the financial statements.

Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions : - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
CIES Cost of Services	The alliance finance model.	Work that went into preparing the S23 agreement and alliance finance model.	Reviewed by Grant Thornton	Whilst this is not strictly an estimate it is a critical judgement and should be brought to the attention of the auditors. Having said that audit should gain assurance from the work they have already carried out for the director of Finance to review the financial model under the S23 agreement. 90% of the expenditure of Warwickshire Police and West Mercia Police is pooled and a cash adjustment is made to ensure each force bears its share of expenditure in line with the S23 agreement. The expenditure is actual substantive expenditure and the 69:31 is set out in the S 23 agreement. A high level review of the cost sharing basis was carried out in 2016/17 and based on the split of employees between the two forces, was found to still be appropriate.	The amount of pooled expenditure in the alliance in 2016/17 is at a similar level to 2015/16.

Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions : - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property plant & equipment valuations	Valuations are made by the external valuer (RICS/CIB Member) in line with RICS guidance on the basis of 5 year valuations with interim reviews	The Financial Accountant notifies the valuer of the programme of rolling valuations or of any conditions that warrant an interim revaluation. The values' report is professionally challenged.	Use of an external valuer.	Valuations are made in line with RICS guidance by the external valuer. The valuers assumptions are challenged.	The valuer produced a detailed report as at 31/1/2017 and subsequently advised the Force tat there were no material changes as at 31/3/2017.
Estimated remaining useful lives of PPE	The following asset categories have general asset lives: •Buildings over UEL years •Vehicles 3-7 years •Plant and IT equipment 5 years	Consistent asset lives applied to each asset category. The valuers' assessment is challenged and reassessed every five years.	Use of an external valuer.	The valuer brings a range of experience to bear in arriving at appropriate asset valuations and UE, which are referred to in the valuation report.	No.
Depreciation & Amortisation	Depreciation is provided for on all fixed assets with a finite useful life on a straight-line basis and a reducing balance method (vehicles)	Consistent application of depreciation method across all assets	No	The length of the life is determined at the point of acquisition or revaluation according to: -Assets acquired are not depreciated until the following financial year. -Assets that are not fully constructed are not depreciated until they are brought into use.	No.

Appendix A Accounting Estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Impairments	Assets are assessed at each year-end as to whether there is any indication that it may be impaired. Where indications exist and possible differences are estimated to be material, the recoverable amount of the asset is estimated. If this is less than the carrying amount of the asset, an impairment loss is recognised.	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired.	Use of an external valuer	Valuations are made in line with RICS guidance by the external valuer. The risk of not identifying a potential material impairment is low based on the knowledge within the Property Services and Finance Team.	No
Non adjusting events - events after the BS date	S151 Officers make the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an non-adjusting event. For these events only a note to the accounts is included, identifying the nature of the event and, where possible, estimates of the financial effect	Heads of Services notify the S151 officers. The Head of Accountancy and Financial Services monitors activity with a view to identifying potential events after the balance sheet date.	This would be considered on individual circumstances	This would be considered on. individual circumstances. The risk of not identifying an event after the balance sheet date is low based on the knowledge of the S151 officers and Finance team.	No

Appendix A Accounting Estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions : - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Measurement of Financial Instruments.	Financial instruments are valued at fair value based on the advice of their internal treasury consultants and other finance professionals.	Advice from finance professionals	No; the financial instruments are not complex. They mainly comprise of borrowing via the PWLB and short-term investment of cash balances. The fair value of PWLB loans is produced by the PWLB.	The non-complex nature of financial instruments reduces the risk of misstatement.	No
Bad Debt Provision.	The level of provision for bad debts is based on an aged breakdown of outstanding debt and knowledge of specific debts to determine an amount that is unlikely to be collected.	The finance team calculate the provision, which is reviewed by the Head of Finance.	No	There is a low risk of material misstatement. The balance calculated is reviewed annually and it is assessed whether better information is available, or there are changing circumstances.	No

Appendix A Accounting Estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions : - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Provisions for liabilities.	Provisions are charged as an expense to the Cost of Services in the Comprehensive Income and Expenditure Statement in the year that the Group becomes aware of the obligation, and are measured at the best estimate as at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties. .	Management review of evidence.	No	The use of experts using specific knowledge about the circumstances surrounding the events or industry knowledge is better than the alternative which would be make a desktop estimate by the Finance Team.	N/A
Accruals	Finance collates accruals of expenditure and income. Activity is accounted for in the financial year that it takes place. Routine accruals for purchases are generated by the finance system through e-procurement, The finance team also prepare manual accruals over £1,000	Due to the volume of accruals and wide range in individuals who can create an accrual, the checking is extensive, carried out by the system and inspection of a sample of source documentation.	No Note we are reliant on the District Councils for Council Tax accruals and the HR Department for the employee toil accrual.	Accruals for income and expenditure have been principally based on known values. Where accruals have to be estimated the latest available information is used and challenged.	No

Appendix A Accounting Estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions : - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
IAS19 Pensions Post Employment Liabilities	Estimation of the pensions liability depends on a number of complex judgements and assumptions relating to the discount rate, the future value of the assets and liabilities of the pension schemes, the rate of increase in pay, changes in retirement ages and mortality rates.	Liabilities are recognised in the year they are earned rather than paid.	Yes Two actuaries are engaged to provide expert advice about the assumptions to be applied to the police pension and Local Government Pension Scheme (LGPS).	The underlying assumptions are agreed with the actuaries using market trends. Actual pensions data for serving, deferred and retired members is used in the calculation.	No.

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